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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 535

UNITED STATES OF AMERICA, *Petitioner*

V.

JOHN CATTO, JR. and ROXANA CATTO

on writ of certiorari to the United States Court of Appeals for the Fifth Court

BRIEF FOR JOHN CATTO, JR. AND ROXANA CATTO

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INDEX

Page

Opinion below 1
Jurisdiction 1
Questions presented 2
Statutes and regulations involved 3
Statement 3
Statement of points to be urged 5
Introduction 6

Argument:

I. The Treasury Regulation requiring an accrual (inventory) basis livestock raiser valuing inventory under the unit-livestock-price method to include raised breeding animals in inventory is contradictory to Section 1231 of the Internal Revenue Code of 1954 and invalid and of no force or effect 8

II. Taxpayers are entitled to correct the error caused by the invalid Treasury Regulation and remove from inventory raised breeding animals included in inventory in compliance with the regulation. Correction of the error caused by the regulation does not constitute a change of accounting method, and therefore, Taxpayers are not required to obtain the consent of the Commissioner of Internal Revenue 25

III. Even if a change of accounting method is involved the law does not require a taxpayer to do a useless thing by applying to the

Commissioner for permission to change a particular item when the facts show that the Commissioner would have refused to consider and act upon such application 31
Conclusion 33
Appendix 35

CITATIONS

Cases:

Albright v. *United States*, 173 F.2d 339 ..... 10, 16
Alcoma Ass'n Inc. v. *United States*, 239 F.2d 365..22
American Can Co. v. *Commissioner*, 317 F.2d 604, certiorari denied, 375 U.S. 993 30
Broida, Stone & Thomas, Inc. v. *United States*, 309 F.2d 486, affirming *per curiam* 204 F. Supp. 841 30
Biddle v. *Commissioner*, 86 F.2d 718, affirmed 302 U.S. 573 22
Commissioner v. *Glenshaw Glass Co.*, 348 U.S. 426 20
Commissioner v. *O. Liquidating Corp.*, 292 F.2d 225, certiorari denied, 368 U.S. 898 30
Commissioner v. *Wilshire Oil Co., Inc.* 95 F.2d 971, reversed on other grounds 308 U.S. 90.... 20
Corn Products Co. v. *Commissioner*, 350 U.S. 46 21
Emerson v. *Commissioner*, 12 T.C. 875 10
Fawn Lake Ranch Co. v. *Commissioner*, 12 T.C. 1139, appeal dismissed 180 F.2d 749 11
Gotfredson v. *Commissioner*, 217 F.2d 673 23
Helvering v. *New York Trust Co.*, 292 U.S. 455 20

Helvering v. *Reynolds Co.*, 306 U.S. 110 21
Helvering v. *Winmill*, 305 U.S. 79 21
Lykes v. *Commissioner*, 350 U.S. 46 21
McDonald v. *Commissioner*, 214 F.2d 341 12
Oberwinder v. *Commissioner*, 149 F.2d 255 22
Scofield v. *Lewis*, 251 F.2d 128 ..... 4, 16, 24, 33
United States v. *Bennett*, 186 F.2d 407 ..... 8, 11
United States v. *Consolidated Edison Co. of New York, Inc.*, 366 U.S. 380 30
United States v. *Ekberg*, 291 F.2d 913, certiorari denied 368 U.S. 920 23
United States of America ex rel. Joseph Accardi v. *Shaughnessy*, 347 U.S. 267 32
Wright Contracting Co. v. *Commissioner*, 316 Fd2d 249. 30
Yellin v. *United States*, 374 U.S. 109 32

Statutes:

Internal Revenue Code of 1954:
Sec. 446(e) (26 U.S.C. Sec. 446) 35
Sec. 1231 (26 U.S.C. Sec. 1231) 35
Internal Revenue Code of 1939:
Sec. 117(j) (26 U.S.C. 1952 ed. Sec. 117(j) 9
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 151(b) 9
Revenue Act of 1951, c. 521, 65 Stat. 452, Sec. 324. 12

Miscellaneous:

98 Cong. Record, Part 6, pp. 8307-8308 14

H. Rep. No. 586, 32d Cong., 1st Sess., p. 32 18
I. T. 3666, 1944 Cum. Bull. 270 ..... 10, 23
I. T. 3712, 1945 Cum. Bull. 176 10
Letter Ruling of Deputy Commissioner, 1945 CCH Fed. Tax Service, Vol. 4, Para. 6129 24
Letter Ruling of Commissioner, 1948 CCH Fed. Tax Service, Para. 6091 10
Mertens, Law of Federal Income Taxation, Vol. 1 Sec. 3.24 19
Mim. 6660, 1951-2 Cum. Bull. 60 ..... 11, 12
Mim. 6776, 1952-1 Cum. Bull. 71 12
S. Rep. No. 781, 82d Cong. 1st Sess., p. 42 18
S. Rep. No. 1632, 83rd Cong. 2d Sess., p. 300 29
T. D. 5423, 1945 Cum. Bull. 70 13

Treasury Regulations 111, Internal Revenue Code of 1939:
Sec. 29.22(c)-6 2

Tresuary Regulations 118, Internal Revenue Code of 1939:
Sec. 39.22(c)-6(f) 2

Treasury Regulations, Internal Revenue Code of 1954:
Sec. 1.61-4 37
Sec. 1.162-12 39
Sec. 1.446(e) (2) (i) 40
Sec. 1.471-6 41

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OPINION BELOW

The district court did not file an opinion. Its findings of facts and conclusions of law in *United States v. Catto* (R. 34-41), are reported at 223 F. Supp. 663. The *per curiam* opinion of the court of appeals is reported at 344 F. 2d 227.

JURISDICTION

The judgment of the court of appeals was entered on April 8, 1965 (R. 49). Mr. Justice Black extended the time for filing a petition for a writ of certiorari to and including September 5, 1965, (R. 108-111). The petition for a writ of certiorari was filed on September 3, 1965, and granted on November 22,

1965 (R. 112). This Court has jurisdiction under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Section 1231 of the Internal Revenue Code of 1954, which permits capital gain treatment on property used in the trade or business, provides that livestock, regardless of age held by the taxpayer for draft, breeding, or dairy purposes and held for more than 12 months, are property used in the trade or business which is subject to the allowance for depreciation and is not properly includable in inventory. Treasury Regulation §1.471-6(f) on the other hand provides in part that a taxpayer who uses the "unit-livestock price method" of valuing inventory must include all livestock raised whether for sale or for draft, breeding or dairy purposes, in inventory. The questions present are:

(1) Whether Treasury Regulation §1.471-6 (f), requiring taxpayers to include raised livestock held for draft, breeding or dairy purposes in inventory, is contradictory to the provisions of Section 1231 of the Internal Revenue Code of 1954 and invalid and of no force and effect?

(2) Whether, the taxpayers, without the consent of the Commissioner of Internal Revenue and in order to correct an error caused by the Commissioner's own regulation, are entitled to remove from inventory raised breeding livestock erroneously included in inventory in compliance with the Treasury Regulation?

(3) Even if a change of accounting method is involved, does the law require a taxpayer to do a use-

less thing by applying to the Commissioner for permission to change a particular item when the facts show that the Commissioner would have refused to consider and act upon such application?

STATUTES AND REGULATIONS INVOLVED

Sections 446(e), and 1231, (a), (b)(1) and (b)(3) of the Internal Revenue Code of 1954, and Sections 1.61-4, 1.162-12, 1.446-1(e) (2)(i), and 1.471-6 of the Treasury Regulations (1954 Code), appear in the Appendix, *infra*, pp. 35-45.

STATEMENT

The taxpayers in the Catto case are ranchers engaged in the business of breeding and raising cattle for the production and sale of calves. In connection therewith they maintain a breeding herd. As circumstances require they add thereto, purchase bulls and cows and selected calves raised by their breeding herd. (R. 2-4).

When the taxpayers commenced their ranching business in 1938 they adopted the accrual (inventory) method of accounting and used the unit-livestock-price method of valuing inventory. In accordance with the applicable Treasury Regulations[1] taxpayers included raised breeding cattle in inventory, whether held for sale or for draft breeding or dairy purposes. As a result of being compelled by these Regulations to include raised breeding animals in inventory, the taxpayers were forced to include in their ordinary income

[1] Reg. 111, §29.22(c)-6; Reg. 118, §39.22(c)-6(f); Reg. §1.471-6(f) promulgated under the 1954 Code.

the initial inventory value of their raised breeding animals and thereafter the annual increases in inventory values assigned to such animals, including the taxable years, 1954 and 1955, here involved. On the other hand, in the years in which such animals were sold, the amount of profit from the sale that was entitled to capital gain treatment under Section 1231, and its predecessor, Section 117(j), was reduced because taxpayers were required to deduct, as the cost basis, the accrued inventory value from sales price in order to compute the profit to which the capital gain rate would apply. (R. 3-5).

Ranchers who use the cash receipts and disbursement method of accounting are not compelled by the Treasury Regulation to maintain an inventory and include in their ordinary income values for their breeding animals. Thus, such taxpayers are permitted to deduct the cost of raising breeding animals ordinary income and to compute their capital gain on the sale of such animals on a zero basis. (R. 7).

After the decision in *Scofield* v. *Lewis*, 251 F 2d 128 (C.A.5), taxpayers filed a claim for refund claiming that Treas. Reg. §1.471-6(f) was contradictory to Section 1231 of the Code, and therefore, invalid and of no force and effect; and that they were entitled to correct the error caused by the invalid Regulation. Prior to filing such claim, taxpayers did not request the Commissioner's permission to change from the accrual to the cash method. However, it was stipulated that the Commissioner, during such years, would not consider such a request. Taxpayers claim was never rejected nor paid and after the expiration of six

months taxpayers sued for a refund and the district court rendered a judgment in their favor. The Fifth Circuit affirmed *per curiam* on the authority of its earlier decision in *Scofield* v. *Lewis, supra,* and, held that the Treasury Regulation which compelled the taxpayer to include raised breeding animals in inventory was invalid and that the taxpayers were entitled to correct the error caused by the Regulation without the Commissioner's consent. (R. 6-8, 43, 46-48).

STATEMENT OF POINTS TO BE URGED

I. The Treasury Regulation requiring an accrual (inventory) basis livestock raiser valuing inventory under the unit-livestock-price method to include raised breeding animals in inventory is contradictory to Section 1231 of the Internal Revenue Code of 1954, and invalid and of no force or effect.

II. Taxpayers are entitled to correct the error caused by the invalid Treasury Regulation and remove from inventory raised breeding animals included in inventory in compliance with the Regulation. Correction of the error does not constitute a change of accounting method, and therefore, taxpayers are not required to obtain the consent of the Commissioner of Internal Revenue.

III. Even if a change of accounting method is involved, the law does not require a taxpayer to do a useless thing by applying to the Commissioner for permission to change a particular item when the facts show that the Commissioner would have refused to consider and act upon such application.

INTRODUCTION

The approach utilized in the Government's brief proceeds on the theory, however well disguised, that regulations affecting inventory can be used as tools to defeat legislative and judicial intent. It will be demonstrated in this brief that this is entirely consistent with the effort, made unremittingly since the enactment of Section 117(j) in 1942, to defeat the application of capital gains treatment to the livestock industry. Initially commencing as an effort to deny its benefits entirely, then retreating step by step in attempts to circumscribe its application by restrictive devices, the assault has here reached a climax through an attempt to discriminate against a segment of the livestock industry through an inventory device which plainly and explicitly is contrary to express statutory language.

A number of basic misconceptions are employed in the rationale of the Government's brief. An understanding of these fallacies is essential to a clear comprehension of the appropriate solution of the issues here presented. For example:

A. The regulation involved *did not* have its genesis in 1924. Regulations then promulgated and cited by the Government do not relate to the unit-livestock-price method of valuing inventory. The regulation involved (Treas. Reg. 1.471-6[f]) was first issued in 1944. Thus, some two years *after* Section 117 (j) was enacted, the Treasury spoke for the first time in setting forth requirements that *breeding animals* must be included in inventory if the taxpayer uses the unit-livestock-price method to value inventory.

B. There is no committee report, no Congressional Record and no other publication which gives any indication that the Congress or any Committee thereof ever dealt specifically with Regulations requiring the inclusion of breeding livestock in an inventory. There is not the slightest hint that in dealing with the issues of livestock and capital gains in 1951 and in 1954, the Congress was even aware of any distinction between cash and accrual basis taxpayers. Indeed the record reflects a preoccupation with the broad capital gains issue in the livestock industry rather than with the niceties of accounting systems, inventory practices and the like. For one to conclude that a Committee of Congress, engrossed in the consideration of broad general concepts of taxation and the applicability of capital gains in a given area, is simultaneously aware of and considering minute and peripheral issues relative to inventory methods, is to ascribe to its members an all-encompassing intent which would appear to be at variance with any rational analysis of their though processes. Indeed, as will be demonstrated, the doctrine of legislative re-enactment has no application unless the Committee verbally or in committee reports indicated familiarity with the subject matter. No such familiarity has been demonstrated here.

C. The premise in the government's brief (Br. 21) that the Commissioner, "as a matter of policy, denied . . . requests" for a change in a method of accounting, is completely inaccurate and contrary to the record. It has been stipulated (R. 7-8) that the Commissioner would have refused to consider, and as a consequence to act upon, such an application. Hence, in

addition to the point strenuously asserted in the body of this brief that a change of accounting method was not involved, it is a hollow mockery to require taxpayers to file a request which would not even be considered and then to indulge in lengthy philosophical discussions about the relative merits and demerits of what might have been contained in the request. The law simply does not require a taxpayer to do a useless thing.

D. The contention is made in the Government brief that in 1951 the situation with reference to breeding livestock and its tax treatment was simplicity itself and clear cut is the extreme. Congress is supposed, in that year, to have "codified" the law (Gov't Br. p. 22). Thus, the argument goes, Respondents had a meaningful choice in 1948 and 1951. Yet *in the very* year, 1951, we find the Government asserting in *United States* v. *Bennett*, 186 F.2d 407, (C.A. 5), that all livestock are necessarily held primarily for sale. Clear and meaningful choice? Of course not!

Other fallacious premises in the Government's position will not here be delineated. Rather, we now proceed with a discussion of the issues.

ARGUMENT

I.

THE TREASURY REGULATION REQUIRING AN ACCRUAL (INVENTORY) BASIS LIVESTOCK RAISER VALUING INVENTORY UNDER THE UNIT - LIVESTOCK - PRICE METHOD TO INCLUDE RAISED

BREEDING ANIMALS IN INVENTORY IS CONTRADICTORY TO SECTION 1231 OF THE INTERNAL REVENUE CODE OF 1954, AND INVALID AND OF NO FORCE OR EFFECT.

A. *The Government Has Consistently Refused To Grant Livestock Raisers The Full Benefit of Capital Gain Treatment.*

The predecessor of Section 1231 of the Internal Revenue Code was enacted by Congress in 1942 when Section 117(j) was added to Internal Revenue Code of 1939.[2] By enactment of Section 117(j), Congress extended capital gain treatment to gains derived from the sale or exchange of certain property used in a trade or business. As originally defined, the term "property used in the trade or business" meant property with these characteristics:

(1) Property used in the trade or business.
(2) Property of character which is subject to to the allowance of depreciation.
(3) Property which was held for more than six months.
(4) Property which was not of a kind which would properly be includable in the inven tory of the taxpayer if on hand at the close of the taxable year.
(5) Property which was not held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

[2] Section 117(j) was added by Section 151(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798.

The Statute made no distinction between the cash and accrual basis taxpayers. Thus, under qualifying circumstances, its favorable treatment was available to cash and accrual basis taxpayers alike.

While the original definition of property used in a trade or business contained no specific reference to livestock, livestock raisers began to claim capital gain treatment on breeding stock sold at the expiration of its usefulness in the breeding herd since such livestock had all the characteristics of such property. The Commissioner of Internal Revenue from the outset attempted to limit and deny the benefits of the new section to breeding stock.[3] However, the Courts uniformly struck down the Commissioner's unfounded attempts to withold from breeding herd owners the capital gain treatment afforded by Section 117(j).

In *Albright* v. *United States*, 173 F. 2d 339 (C. A. 8), decided on March 10, 1949, the Eighth Circuit, reversing the Government, held that a cash basis dairy farmer, maintaining his herd at normal size throughout the taxable year, was entitled to capital gain treatment on his regular sale of excess or worn out animals from the herd under circumstances where the other statutory requirements were met. The Court specifically held that the Commissioner's administrative rulings attempting to limit and restrict the application of Section 117(j) were invalid.[4]

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[3] I.T. 3666, 1944 Cum. Bull. 270; I.T. 3712, 1945 Cum. Bull. 176; and Letter of Commissioner, Aug. 4, 1947 (1948 C.C.H. 6091), as citde in Albright v. United States, supra, 173 F. 2d 339, 343 (C.A. 8).

[4] June 27, 1949, the Tax Court of the United States, on the authority of Albright, supra, gave the same treatment to a cash basis dairy farmer. Emerson v. Commissioner, 12 T.C. 875.

After it became apparent that the claim of cash basis livestock raisers to capital gains treatment could not be defeated, the Commissioner directed his attack in denying capital gain treatment to accrual (inventory) basis livestock raisers. In *Fawn Lake Ranch* v. *Commissioner*, 12 T.C. 1139, appeal dismissed 180 F. 2d 749 (C.A. 8), the Tax Court held that accrual basis livestock raisers were entitled to the benefits of Section 117(j).[5]

Despite these repeated set-backs the Commissioner elected to stubbornly and relentlessly continue his fight to limit the benefits of Section 117(j) to the livestock industry. He suffered his next major defeat in *United States* v. *Bennett*, 186 F. 2d 407, decided on June 8, 1951, where the court rejected the Government's contention that all livestock are held primarily for sale and ruled that culls, sold out of a cash basis taxpayer's breeding herd, were entitled to Section 117(j) treatment.

The Commissioner, however, proceeded to fight on. In Mim. 6660, 1951-2, Cum. Bull. 60, it was announced that prior administrative rulings would be revoked in the light of the *Albright* and similar decisions, but for the first time the Commissioner arbitrarily stated that capital gain treatment would be denied on sales of younger animals which were not used as breeders for substantially their full lives.

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[5] The Tax Court pointed out that breeding herd animals were not properly includable in inventory and the fact that such animals had been included in inventory could not defeat the taxpayer's claim to capital gain treatment, since their inclusion was in compliance with the Commissioner's ruling, 12 T.C. at p. 1144.

As a result of the Commissioner's unfounded attempt to qualify and limit the *Albright* and similar decisions, Congress amended Section 117(j) by adding thereto Section 324 of the Revenue Act of 1951, c. 521, 65 Stat. 452. The amendment made the Section specifically applicable to livestock, regardless of age, held by taxpayer for draft, breeding, or dairy purposes and held for 12 months or more from the date of acquisition.[6] Thereafter, the Commissioner revoked Mim. 6660, see Mim. 6776, 1952-1 Cum. Bull. 71. However, even after the enactment of the amendment to Section 117 (j) the Commissioner *unsuccessfully* attempted to impose new standards of age and reproductive capacity on the sales of young animals by livestock raisers. *McDonald* v. *Commissioner*, 214 F.2d 341 (C.A. 2)

The instant case clearly demonstrates that the Commissioner has not elected to abandon his stubborn and relentless attack to deny the *full benefit* of capital gain treatment to members of the livestock industry.

B. *The Treasury Regulation Results In Discrimination Against These Taxpayers.*

There can be no question that, as the result of the amendment to Section 117(j) and the re-enactment of that Section as Section 1231 of the Internal Revenue Code of 1954 applicable to the years in issue, breeding herd animals, regardless of age, are property used in a trade or business subject to the allowance for deprecia-

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[6] The amendment to Section 117(j) was made applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months was made applicable only with respect to taxable years beginning after December 31, 1950.

tion and *not properly includable in inventory.* Treasury Regulation §1.471-6(f) promulgated under the 1954 Code, however, requires a taxpayer who uses the unit-livestock-price method in valuing inventory to apply it to all livestock raised, whether they are raised for sale in the ordinary course of business or for inclusion in the breeding herd, thereby compelling the inclusion of raised breeding herd animals in inventory at a unit value.[7]

It would appear to be elementary that a regulation which directly contravenes the plain and unambiguous terms of a statute is invalid and no force and effect. The statute in question clearly states that raised breeding animals are not properly includable in inventory; the Regulation, however, requires that such animals must be included in inventory.

The net effect of the Regulation in question is to discriminate against accrual basis ranchers, such as these taxpayers, who use the unit-livestock-price method to value their inventory. Ranchers who use the cash method are not compelled by the Regulations to maintain an inventory and include in their ordinary income values for breeding animals.[8] Such ranchers, as are all ranchers, are permitted to deduct the cost connected with raising livestock. Treas. Reg. §1.62

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[7] This Regulation was originally issued in December, 1944, T.D. 5433, 1945 Cum. Bull. 70, as an amendment to Treas. Reg. 111, §29.22(c)-(6), and was carried forward in Treas. Reg 118, §38.22(c)-6(f) issued in 1953 and applicable to the taxable years beginning after 1951.

[8] Similarly, accrual (inventory) basis taxpayers who use the farm-price method of valuing inventories, are not compelled to include their raised breeding animals in inventory. Treas. Reg. §1.61-4, 1.471-6(d).

-12.[9] Thus, the cash basis rancher is entitled to carry raised breeding animals at a zero basis, and when such animals are sold, capital gain treatment is permitted on the entire sales price.

While the accrual basis rancher using the unit-livestock-price method is entitled to deduct the cost of raising livestock, the Commissioner offsets the benefit of such deduction by requiring him to include raised breeding livestock in inventory at a unit value, along with his livestock held primarily for sale, and to increase the unit value until the livestock reaches maturity. By adding these unit values to inventory and annually increasing such values, the rancher's ordinary income is increased, and the Commissioner thereby effectively offsets the deduction for raising costs. When such livestock is sold, the rancher must deduct the unit values from the proceeds of the sale. Thus, the Regulation increases the accrual basis rancher's ordinary income and limits his right to capital gain.

A simple example clearly demonstrates the discriminatory effect of the Commissioner's Regulation:

> A, a cash basis rancher, raises a cow for his breeding herd at a cost of $35.00. He is permitted to deduct the cost of raising the cow against ordinary income, but he is not compelled by statute or regulation to include the value of the

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[9] The right was originally granted in 1921 by Reg. 45, Art. 110. The deduction is, and has been granted to all livestock ranchers, regardless of whether they are on the cash or accrual method and regardless of what method of valuation they use. See Letter of June 27, 1952, from Secretary of the Treasury to Chairman of the Senate Finance Committee, 98 Cong. Rec., Pt. 6, pp. 8307-8308 (R. 9-15), herein referred to as Letter From Secretary of Treasury.

cow in inventory and increase his ordinary income. When she is five years old he sells her for $100.00. The Commissioner concedes that under the statute and regulations that A is entitled to capital gain on the entire $100.00.

B, an accrual basis rancher who uses the unit-livestock-price method to value his inventory, also raises a cow for his breeding herd at a cost of $35.00. He is also permitted to deduct the cost of raising the cow but he is compelled by the Regulation to include the cow in inventory at $35.00. Thus, he is required to include the $35.00 in ordinary income and pay ordinary income tax thereon. When B's cow is five years old, B sells her for $100.00. Under the Government's contention in this case and the Regulation, B gets capital gain treatment only on the difference between $35.00 (inventory value) and $100.00 (selling price) or $65.00.

Thus, by the benign device of forcing raised breeding animals in inventory, along with animals held primarily for sale, the Commissioner has converted into ordinary income what would otherwise, if the rancher was on the cash basis, be taxed as capital gain. As a consequence, the Regulation discriminates against the accrual basis taxpayer who uses the unit-livestock-price method to value inventory. In doing so, the Regulation violates the clear intent of Congress in enacting Section 117(j) in that:

> "Section 117(j) was intended as a relief measure *applicable alike* to all taxpayers within its

provision, *Leland Hazard* v. *Commissioner*, 7 T.C. 372. That it was so intended is clearly expressed in the report of the Committees of the House of Representatives and the Senate in charge of the bill See H. Rep. No. 2333, 77th Cong., 2d Sess, pp. 53-54 (1942-2 Cum. Bull. 372, 415), and S. Rep. No. 1631, 77th Cong. 2d Sess., p. 50 (1942-2 Cum. Bull. 504, 545)." *Albright* v. *United States*, 173 F. 2d 339, 344 (emphasis added).

It was not, therefore, surprising when the court of appeals struck down the Regulation as invalid and in conflict with the statute in *Scofield* v. *Lewis*, 251 F. 2d 128. The court there stated at page 132:

> " . . . The Regulations must, by their terms and in their application, be in harmony with the statute. A Regulation which is in conflict with or restrictive of the statute is to the extent of the conflict or restriction, invalid. A Regulation valid when promulgated, became invalid upon the enactment of a statute in conflict with the Regulation. The only authority conferred, or which could be conferred, upon the Treasury Department is to make regulations to carry out the purposes of the statute. *Miller* v. *United States*, 294 U.S. 435, 55 S. Ct. 440, 79 L. Ed. 977, rehearing denied 294 U. S. 734 55 S. Ct. 635, 79 L. Ed. 1262; *Newman* v. *Commissioner*, 5 Cir., 1935, 76 F. 2d 449 certiorari denied 296 U.S. 600, 56 S. Ct. 116, 80 L. Ed. 425."

When Congress determined that breeding animals were property used in trade or business and, therefore, that the gain on their sale was capital gain, it became necessary to distinguish between animals held for sale and animals held for breeding purposes. At that time, it became improper to include animals held for breeding purposes in inventory.[10] At that time it became incumbent upon the Commissioner to change the Regulation. However, he has consistently refused to do so. His refusal, we submit, is but another of his unyielding efforts to limit and deny capital gain treatment to the livestock industry, and to frustrate judicial construction and Congressional intent which made Section 117(j), and its successor Section 1231, "applicable alike to all taxpayers within its provisions."

C. *Congress Has Not Approved The Discriminatory Effect of The Regulation.*

The Government attempts to justify the discriminatory effect of Treasury Regulation §1.471-6 (f), and its predecessors, by asserting that Congress intended to approve the disparity which existed between cash and accrual basis taxpayers who use the

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10 Subsequent to the authorization of capital gains on breeding livestock, the distinction in treatment between animals held for breeding purposes and animals held for sale is in itself entirely reasonable. Under the accounting theory of the accrual method, animals held primarily for sale to customers do, in fact, increase in value each year as they add weight and maturity. Therefore, the accrual basis taxpayer accurately reflects income by including therein the estimated increase in such value each year, thereby securing the advantage of "averaging" his income over the years during which animals are held. On the other hand, animals held for breeding purposes in fact decline in value to the owner each year they are so used. Their main value is as breeders and normally they are not sold until some event occurs which diminishes their value as breeders. Thus, increased weight and maturity are largely meaningless to the owner of a breeding herd, and no income is actually realized, even in the accrual basis concept of that term, until the year in which they are sold.

unit-livestock-price method to value inventory when it enacted the amendment to §117(j) in 1951 (Br. 14-15). The Government argues that Congress, in effect, froze such discriminatory treatment into law by precluding a change in the cash method of accounting. This argument is totally lacking in vitality. The Committee Reports referred to by the Government [11] do not reflect any consideration whatsoever of the effect of the amendment on cash or accrual basis taxpayers, or that Congress was even aware of the disparity in treatment between the methods. Further, the Reports do not reflect Congress was aware that the disparity in treatment was caused by the Commissioner's Regulation which compels the inclusion of breeding livestock in inventory. The Committee simply did not have the question before it. It is clearly apparent from the Reports that Congress was concerned with only one consideration, namely, to specifically authorize capital gain treatment for livestock used for draft, breeding or dairy purposes, and to thwart the Commissioner's continuing unfounded attempts to limit and deny capital gains to the livestock industry.

In the same vein the Government argues that the legislative history (Letter from Secretary of Treasury) and the statutory re-enactment of the provisions for breeding cattle "verbatim" in the 1954 Code (as §1231) prevented the Treasury Department from amending the regulations relating to cash method ranchers and also gave effect of law to the regulations re-

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[11] S. Rep. No. 781, 82d Cong., 1st Sess. p. 42; H. Rep. No. 586, 82d Cong., 1st Sess., p. 32.

lating to accrual method ranchers.[12] The Government's argument is predicated on the erroneous assumption that the Secretary of Treasury's letter has probative value as legislative history.[13] The letter's only claim to fame is that it was introduced in the Congressional Record. However, it was introduced on a day when the Senate was not considering problems of Federal income taxation and it was introduced without comment. The Government has made no showing whether or not the letter was even considered by the Senate or House of Representatives as a whole or in committee. The letter nowhere even mentions or makes reference to the fact that the Commissioner by

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[12] The same argument is advanced by the Government in support of its contention that Congress approved the Commissioner's refusal to permit accrual ranchers to switch to the cash basis (Br. 23). It is equally erroneous and untenable for the reasons set forth in the brief.

[13] The Government's argument also assumes that the so-called "Rule of Statutory Re-enactment" has validity today. In **Mertens**, Law Federal Income Taxation, Vol 1, §3.24, pp. 45-52, the rule is characterized as:

> "an anachronism left over from earlier days in which statutes were briefer, were seldom reenacted or amended, and where administrative interpretation was far simpler. In income tax matters where in early years there was a new revenue act at least every two years, then a codification in the 1939 Code, continuing new revenue acts and finally the total rewritten 1954 Code, and with the Board, the Tax Court, and the district and circuit courts often issuing conflicting decisions, the policy of administrative interpretation is often based on the principal of expediency. In this area it is obvious that the ordinary presumption as to Congressional familiarity with administrative interpretation is an archaic fiction."
>
> "In complex income tax law it is absurd to indulge in the fiction that the full import of Treasury Regulations and administrative practice is known to the members of Congress . . . As the Supreme Court said in the case of Helvering v. Hallock: . . . 'we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principal.' . . . The fallacy in the frequently expressed rule that reenactment of a statute gives the force of law to prior interpretation is that it is unreasonable to assume that Congress was familiar with such interpretation unless it verbally or in committee reports indicated familiarity with such interpretation."

his regulations was requiring taxpayers who use the unit-livestock-price method to include their raised breeding animals in inventory.[14] The letter merely discusses cash and accrual methods of accounting and the situation as to farmers and ranchers under the two accounting methods. Thus, the unit-livestock-price method, a method of inventorying livestock, is not the subject matter of discussion in the letter at all. Certainly the letter cannot be regarded as apprising Congress in most thorough and clear terms of the way the Commissioner was administering the law regarding livestock held for breeding purposes.

It would seem to be equally arguable that had Congress known the reason for the inequity was the regulation requiring the inclusion of raised breeding livestock in inventory by users of the unit-livestock-price method, the inequity would have been corrected. Thus, equally as reasonable as the Government's conclusion is the conclusion that because Congress was unaware of the basic cause of the inequity, its failure to take action to cure it is meaningless. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431; *Commissioner* v. *Wilshire Oil Co.*, 95 F. 2d 971 (C.A. 9), reversed on other grousds, 308 U.S. 90; *Helvering* v. *New York Trust Co.*, 292 U.S. 455, 468.

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[14] In all probability, Congress was unaware of the requirement of Reg. §1.471-6(f) where it re-enacted §117(j) as amended as §1231 of the 1954 Code. The Regulation concerns itself not with capital gains but with inventory methods. From a standpoint of physical arrangement within the Regulations themselves, it is far removed from the provisions relating to capital gains. Furthermore, where the Internal Revenue Code was adopted, the Code alone comprised over 1000 pages, and the Treasury Regulations were several times this length. Thus, it is unreasonable to assert that Congress, with its membership changing continuously over the years, knew the full import of all Treasury Regulations when the Internal Revenue Code of 1954 was enacted.

The cases cited by the Government (*Helvering* v. *Winmill*, 305 U.S. 79; *Corn Products Co.* v. *Commissioner*, 350 U.S. 46; *Lykes* v. *United States*, 343 U.S. 118; *Helvering* v. *Reynolds Co.*, 306 U.S. 110; Br. 16) in support of the proposition that Congressional inaction to the Treasury's request indicates a Congressional intent to leave the situation as it existed further demonstrates the fallacy of the Government's argument. Those cases involved situations wherein a statute was enacted, later an administrative interpretation of the statute was issued, and thereafter the same provisions of the statute were re-enacted by Congress. Thus, in those cases we find the court quite reasonably holding that the re-enactment constituted legislative approval of the administrative interpretation.

In this case, however, the facts and sequence of events were definitely not the same as in the cases cited by the Government. Here, in 1945, the Commissioner issued a regulation requiring accrual basis taxpayers using unit-livestock-price method to include *all* animals in inventory. In 1951, Congress amended Section 117(j) to specifically include livestock. The 1954 Code re-enacted the relevant provisions of the 1951 amendment. A regulation followed by the amendment of a statute directly in conflict therewith and subsequent re-enactment thereof simply cannot form a basis for the presumption that congress intended by the re-enactment to embrace the terms of the invalid regulation.

Moreover, where the statute itself is plain and needs no administrative construction, the doctrine of

statutory re-enactment has no application. See *Biddle* v. *Commissioner*, 86 F. 2d 718 (C.A. 2) affirmed, 302 U.S. 573; *Alcoma Ass'n, Inc.* v. *United States*, 239 F. 2d 365 (C.A. 5); *Oberwinder* v. *Commissioner*, 147 F. 2d 255 (C.A. 8). Obviously, the statute here is plain enough and needs no administrative construction. The amendment to Section 117(j) which was re-enacted "verbatim" in the 1954 Code clearly and unequivocally says that livestock held for breeding purposes is property used in the trade or business of the taxpayer. Accordingly, such livestock are not properly includable in inventory and the regulation which compels their inclusion in the inventory is contradictory to the statute and therefore invalid.

D. *The Taxpayers Have Been Denied a Knowledgeable Choice As To Accounting Methods.*

The Government throughout its Brief contends that both cash and accrual methods of accounting have certain advantages and disadvantages and that when a taxpayer elects his accounting method he not only accepts the advantages, but the disadvantages as well. This reasoning, must, of necessity, assume that the taxpayer had knowledge of the advantages and disadvantages at the time the election is made. However, such reasoning should not be applicable to a situation when the disadvantages were non-existent at the time of election.

Prior to 1951, there was considerable litigation in the courts between taxpayers, such as Elkberg and Bennett, and the Government over the entitlement of capital gains treatment on sale of breeding livestock. Finally, in 1951 it was necessary for Congress to

amend Section 117(j) to make the section specifically applicable to livestock. It has been judicially recognized that the purpose of the amendment in 1951 "was chiefly to clarify the issue and to recognize by statutory enactment the rulings which had been made by the courts". *Gotfredson* v. *Commissioner*, 217 F. 2d 673, 676 (C.A. 6). Thus, it was not until Congress acted in 1951 that it became clear that breeding livestock were subject to capital gain treatment.

When the taxpayers in the instant case had their choice to elect the cash or accrual method of accounting and select a method of valuing inventory in 1938 when they commenced their ranching operations it was not recognized that a rancher could get capital gains treatment on the sale of his breeding animals under any circumstances, regardless of what method of accounting and what method of valuation was adopted. Therefore, these taxpayers did not have a meaningful choice as to accounting and valuation methods because they had to make their selection long prior to 1951 and the consequences of the options available were not known.

And even if it is assumed that it was recognized that capital gains treatment was available on the disposition of breeding livestock if all the other elements were satisfied when the Internal Revenue Service issued I. T. 3666, 1944 Cum. Bull. 270, and that a taxpayer commencing business after that date had a knowledgeable choice as to accounting methods,[15] this would

[15] This was the principal ground upon which **Lewis** was distinguished and certiorari was opposed by the Government in **United States** v. **Ekberg**, 291 F. 2d 913 (C.A. 8), certiorari denied, 368 U.S. 920 See Brief for the United States In Opposition, pp. 7-8.

have no application to these taxpayers. If these taxpayers had attempted to change from the accrual to the cash method when they continued the operation of their portion of the ranches as a sole proprietorship in 1948 and 1951, they would have been required to secure the Commissioner's consent. [16] There can be no question, and the *Lewis* case clearly shows, that the Commissioner would not even consider such a request, much less approve it, 251 F. 2d at 231.[17] Thus, even under this theory, taxpayers' selection of accounting method was prior to the recognition of capital gains treatment on livestock, and as a consequence, these taxpayers were denied a knowledgeable choice as to accounting and valuation methods.

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[16] See letter ruling of the Deputy Commissioner, 1945 CCH Fed. Tax Service, Vol. 4, para. 6129, where the Internal Revenue Service ruled that if income from a business operated by an individual was reported on the accrual basis and such business is succeeded by a partnership, permission of the Commissioner is required to change to the cash method. The Government's purported distinction of that ruling is untenable and based upon facts not contained in the ruling. There is nothing contained therein to support the Government's assertion that a sole proprietorship accepted a new investor; the new partner could have just as easily been accepted to render services. Similarily, there is nothing to support the assertion that there was no substantial change in the business in that instance. In the instant case, the business carried on by the two sisters was substantially the same as, and not materially different from, the business carried on by the partnership, namely, to conduct the business of breeding and raising cattle for the production and sale of calves on two ranches in West Texas.

Also, in determining whether the taxpayers had a meaningful choice as to accounting and valuation methods in 1948 and 1951, the Court should look to the situation that existed at that time, and not the Treasury Regulations promulgated under the 1954 Code and decisions thereunder which are cited in the Government's Brief, (Br. 25).

[17] In the instant case it was stipulated that during the years 1954-1958, the Commissioner refused to consider rancher's requests to change from the accrual method to the cash method (R. 7-8). A similar situation existed in prior years, Scofield v. Lewis, 251 F. 2d at 131. It is obvious, as evidenced by the Government's position herein, that the Commissioner would have opposed permission to drop such an item from inventory.

II.

TAXPAYERS ARE ENTITLED TO CORRECT THE ERROR CAUSED BY THE INVALID TREASURY REGULATION AND REMOVE FROM INVENTORY RAISED BREEDING ANIMALS INCLUDED IN INVENTORY IN COMPLIANCE WITH THE REGULATION. CORRECTION OF THE ERROR CAUSED BY THE REGULATION DOES NOT CONSTITUTE A CHANGE OF ACCOUNTING METHOD, AND THEREFORE, TAXPAYERS ARE NOT REQUIRED TO OBTAIN THE CONSENT OF THE COMMISSIONER OF INTERNAL REVENUE.

A. *The Commissioner's Consent Is Not Required to Correct An Error Caused By An Invalid Regulation.*

The court of appeals held in the instant case, 344 F. 2d at 229, as it did in the *Lewis* case, 251 F. 2d at 132, that the taxpayers are permitted to remove property used in their trade or business from inventory without the Commissioner's consent. The court of appeals recognized in the *Lewis* case that the Commissioner had the authority to approve or disapprove a change in the accounting method; however, it flatly refused to sanction the effort of the Commissioner to enforce an invalid Regulation by the indirect means of claiming that failure to follow the invalid Regulation

amounted to a change of accounting method requiring the Commissioner's consent. The courts of appeals in effect pointed out in the *Lewis* case that the rule of not changing accounting methods without the Commissioner's consent had no application when the taxpayer was simply undoing what the invalid Regulation had wrongfully required him to do.

The impact of the Government's brief is that even though the Regulation is invalid, the Commissioner's consent is required in any event to correct the error caused by the Regulation. The Government's position is apparently premised on the ground that an accrual basis taxpayer who maintains an inventory can under no circumstances remove or omit an item from inventory once it is included therein, regardless of how it became included in inventory in the first place. A concrete example may serve to underscore the basic incorrectness of the Government's position.

A Woolworth store is admittedly required to keep an inventory on all property held primarily for sale. Let us suppose that a Commissioner issues a Regulation requiring the inclusion of the soda fountain in inventory. Woolworth complies but after the passage of several years, another litigant obtains a decision invalidating the Regulation. What is Woolworth to do? Can they simply drop the item from their inventory when they learn of the decision or must they apply to the Commissioner for permission? Suppose further that the Commissioner refused to grant permission to drop these items from inventory.

It would seem plain and clear that Woolworth could drop the item from inventory and that the law would not require them to do a useless thing, namely, to ask for permission which they knew would not be granted and which in reality was not required because of the invalidity of the Regulation. Permission would not be required for another reason: the dropping of the soda fountain from inventory does not effect any change of accounting method. All it does is omit from the inventory an item which was never held primarily for sale and, therefore, never belonged in inventory in the first place.

The mere fact that Woolworth (after dropping the soda fountain from inventory) continues to inventory *merchandise* does not make their accounting method a hybrid and an illegal method. What they are doing is maintaining in inventory that which is held primarily for sale (merchandise) and omitting that which is held primarily for use in trade or business (the soda fountain).

The same rules apply to breeding herd animals belonging to taxpayers. The omission of these livestock from inventory is no more of a hybrid accounting system, and no more requires the Commissioner's permission than does the Woolworth illustration. To permit the Commissioner to do otherwise would be tantamount to saying to him, in effect, "If you issue an invalid Regulation which contravenes the Statute, you can still require all taxpayers affected by the Regulation to obtain permission from you to disregard it, even though you arbitrarily refused to consider applications to change". This, the court of appeals properly

held in the instant case and in *Lewis* case, the Commissioner could not do. [18]

B. *The Statute, Regulation and Legislative History Do Not Require Commissioner's Consent to Correct An Error Caused by An Invalid Treasury Regulation.*

Taxpayers submit that in any event an analysis of Section 446(e) of the Internal Revenue Code of 1954, Treasury Regulation, §1.446-1(e) and the legislative history of Section 446(e) clearly indicate that removing raised breeding animals from inventory to correct an error caused by the regulation does not constitute a change of accounting method requiring the Commissioner's consent.

The statute itself (Section 446(e) of the Code) is silent as to what constitutes a change of accounting method; it merely provides that taxpayer who changes the method of accounting must secure the consent of the Secretary of his delegate. The Regulation (Treas. Reg. §1.446-1(e) (2) (i)) on the other hand tells us that a change in the method of accounting includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item.

The taxpayers here certainly are not changing

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[18] The court of appeals stated in the instant case that the taxpayers were justified in correcting the error which the regulation imposed "even though it results in an inordinate deduction against ordinary income in the year in which the correction is made," 344 F. 2d at 229. There is nothing in the record to support the conclusion that the correction would result in an inordinate deduction. This would depend on the taxpayer's tax bracket at the time of inclusion (about which the record is silent) and the time of removal.

their general method of accounting from the accrual (inventory) basis to the cash receipts and disbursements method. After correcting an error and removing breeding animals from inventory, taxpayers will still be on the accrual (inventory) basis and will value animals *held for sale* in the ordinary course of business (the only animals properly includable in inventory) under the unit-livestock-price method at the same unit values. Thus, the method, system and values would be the same.

Similarly, the Taxpayers here, by correction of an error caused by the invalid Regulation would not be changing the treatment of a material item. While the Regulation fails to define what is contemplated by the phrase "changing the treatment of a material item," the legislative history of Section 446(e) is enlightening. The Committee Report, (S. Rep. No. 1622, 83rd Cong., 2d Sess., p. 300) states in part:

> "It (a change in the method of accounting) includes a change in the treatment of a material item such as *a change in the method of valuing inventory*, or a change from an accrual method without estimating expenses to an accrual method with estimated expenses, or vice versa, or a change in the method of depreciating any property." (Emphasis added).

Thus, if the taxpayers in this case were attempting to change their method of valuing inventory, such as from the unit-livestock-price method to the farm-price method, it would be a change of a material item, and would constitute a change of accounting method.

But taxpayers here are making no such attempt; after correcting the error taxpayers will value the animals properly includable in inventory under the unit-livestock-price method just as before. Therefore the Commissioner's permission to correct the error is not required.

Nor, do we have a situation here analagous to the various cases cited in the Government's Brief (Br. 21, fn. 14) [19] where the taxpayers initiated the erroneous accounting treatment and thereafter attempted to change it without the Commissioner's consent. Here, the erroneous treatment is compelled by the Commissioner's invalid Regulation which the Commissioner refuses to correct. Moreover, this is not a case where "the Commissioner is not necessarily opposed to the change" which taxpayer wants to make; here, by refusing to even consider, much less act upon, a request to change, the Commissioner is, in effect, contesting taxpayer's making a proposed change at all. See *American Can Co.* v. *Commissioner*, 317 F.2d 604 (C.A. 2) at page 606 citing *United States* v. *Consolidated Edison Co. of New York, Inc.*, 366 U.S. 380.

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[19] **American Can Co.** v. **Commissioner**, 317 F. 2d 604 (C.A. 2) certiorari denied, 375 U.S. 993; **Wright Contracting Co.** v. **Commissioner** 316 F. 2d 249 (C.A. 5); **Commissioner** v. **O. Liquidating Corporation**, 292 F. 2d 225 (C.A. 3), certiorari denied, 368 U.S. 898; **Broida, Stone & Thomas, Inc.** v. **United States**, 309 F. 2d 486 (C.A. 4), affirming **per curiam** 204 F. Supp. 841 (N.D.W.Va.).

III.

EVEN IF A CHANGE OF ACCOUNTING METHOD IS INVOLVED, THE LAW DOES NOT REQUIRE A TAXPAYER TO DO A USELESS THING BY APPLYING TO THE COMMISSIONER FOR PERMISSION TO CHANGE A PARTICULAR ITEM WHEN THE FACTS SHOW THAT THE COMMISSIONER WOULD HAVE REFUSED TO CONSIDER AND ACT UPON SUCH APPLICATION.

Conceding for the sake of argument only, that a change of accounting method was involved, it would have been useless for the taxpayers here to have filed with the Commissioner an application to change. It has been stipulated that the Commissioner would have refused to consider, and as a consequence to act upon, such an application. (R. 7-8). This is precisely the same situation which existed during the years involved in the *Lewis* case, 251 F.2d at 131.

Conceded, the statute gave to the Commissioner the power to pass on applications for a change of accounting method. Conceded also, the Commissioner is vested with discretion to refuse applications. *The Commissioner, however, is not vested with the power or authority to arbitrarily refuse to even consider applications.*

This Court has previously enunciated the doctrine which requires that public officials vested with discretion power must exercise that discretion and may not arbitrarily determine issues without even considering the merits. As stated by Mr. Justice Clark in *Uni-*

ted States ex rel. Accardi v. *Shaughnessy*, 347 U.S. 260, 267, in a case wherein the Board of Immigration Appeals had predetermined its decision:

> "An if the word 'discretion' means anything in a statutory or administrative grant of power, it means that the recipient must exercise his authority according to his understanding and conscience."

In like manner in *Yellin* v. *United States* 374 U. S. 109, 122, this Court, through Chief Justice Warren, reiterated the position by asserting that even though "Yellin might not prevail" even if given a hearing, nonetheless he was at least entitled to have the Committee (in that instance) "give him consideration."

The taxpayers submit that the Commissioner is not empowered to categorically refuse to even consider applications and then when relief is sought through the Courts, to blandly assert that the filing of these very applications is a condition precedent to the institution of legal action.

After the enactment of the amendment to Section 117(j) and the re-enactment of that Section as Section 1231 of the 1954 Code, it was incumbent upon the Commissioner to make available to accrual basis taxpayers who use the unit-livestock-price method to value inventory, a means whereby such taxpayers could avail themselves of the full benefits of capital gains treatment. It is inequitable and unfair to now permit the Commissioner to successfully assert that the taxpayers are to be denied the full benefits of capi-

tal gains treatment (available to cash basis taxpayers) because they did not pursue a remedy which was never available to them in the first place. Certainly, this "was not what the Congress intended." *Scofield* v. Lewis, 25 F.2d at page 132.

CONCLUSION

In the earliest definitive case (*Albright*) dealing with the application of the capital gains statute to the livestock industry, it was held that the statute was *applicable alike* to all taxpayers within its provisions. No court, no committee of Congress, no house of Congress has never issued any pronouncement, made any report or even hinted at any thought that any taxpayer, otherwise qualified, should be denied the full benefits of what has been labelled a "relief measure".

In essence the Government's argument here is a thinly veiled effort to circumvent the plain intent of the Congress and the Courts. It is an effort to deprive taxpayers such as these, who are valuing animals on the unit-livestock-price inventory method, of a substantial portion of the relief accorded to others. It is well and good to discuss accounting theory, inventory practices and the entire gamut of income taxation, but what is left when the veneer is removed is still a statute and a regulation which plainly contravenes its terms. No amount of philosophical and technical dissertation can obscure that fact. It is that plain and simple.

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1954:

SEC. 466. GENERAL RULE FOR METHODS OF ACCOUNTING.

* * * *

(e) *Requirement Respecting Change of Accounting Method.*—Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary or his delegate. (26 U.S.C. 446)

SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) *General Rule.*—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or inoluntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges and conversions, such gains and losses shall not be con-

sidered as gains and losses from sales or exchanges of capital assets. * * *

* * * *

(b) *Definition of Property Used in the Trade or Business.*— For purposes of this section.

(1) *General Rule.* The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not —

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year.

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition or similar property, held by a taxpayer described in paragraph (3) of section 1221.

* * * *

(3) *Livestock.*—Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held

by him for 12 months or more from the date of acquisition. Such term does not include poultry.

* * * *

(26 U.S.C. 1231.)

Treasury Regulations on Income Tax (1954 Code):

§1.61-4 *Gross income of farmers.*

(a) *Farmers using the cash method of accounting.* A farmer using the cash receipts and disbursements method of accounting shall include in his gross income for the taxable year—

(1) The amount of cash and the value of merchandise or other property received during the taxable year from the sale of livestock and produce which he raised,

(2) The profits from the sale of any livestock or other items which were purchased,

(3) All amounts received from breeding fees, fees from rent of teams, machinery, or land, and other incidental farm income,

(4) All subsidy and conservation payments received which must be considered as income, and

(5) Gross income from all other sources. The profit from the sale of livestock or other items which were purchased is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale or purchased animals held for draft, breeding, or dairy purposes, the profits shall be the amount of any excess of the sales

price over the amount representing the difference between the cost and the depreciation allowed or allowable (determined in accordance with the rules applicable under section 1016(a) and the regulations thereunder).* * *

(b) *Farmers using an accrual method of accounting.* A farmer using an accrual method of accounting must use inventories to determine his gross income. His gross income on an accrual method is determined by adding the total of the items described in sub-paragraphs (1) through (5) of this paragraph and subtracting therefrom the total of the items described in sub-paragraphs (6) and (7) of this paragraph. These items are as follows:

(1) The sales price of all livestock and other products held for sale and sold during the year;

(2) The inventory value of livestock and products on hand and not sold at the end of the year;

(3) All miscellaneous items of income, such as breeding fees, fees from the rent of teams, machinery, or land, or other incidental farm income;

(4) Any subsidy or conservation payments which must be considered as income;

(5) Gross income from all other sources;

(6) The inventory value of the livestock

and products on hand and not sold at the beginning of the year; and

(7) The cost of any livestock or products purchased during the year (except livestock held for draft, dairy, or breeding purposes, unless included in inventory). All livestock raised or purchased for sale shall be added in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Livestock acquired for draft, breeding, or dairy purposes and not for sale may be included in the inventory (see sub-paragraphs (2), (6), and (7) of this paragraph) instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently from year to year by the taxpayer. When any livestock included in an inventory are sold, their cost must not be taken as an additional deduction in computing taxable income, because such deduction is reflected in the inventory. See the regulations under section 471.

§1.162-12 *Expenses of farmers.*

A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. The purchase of feed and other costs connected with raising live-

stock may be treated as expense deductions insofar as such costs represent actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. * * * Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with §1.61-4. * * *

* * * *

§1.446-1 *General rule for methods of accounting.*

* * * *

(e) *Requirement respecting the adoption or change of accounting method.* * * *

(2) (i) Except as otherwise expressly provided in chapter 1 of the Code and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. A change in the method of accounting includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item. Consent must be secured whether or not a taxpayer regards the method from which he desires to change to be proper. Thus, a taxpayer may not compute his taxable income under a method of account-

ing different from that previously used by him unless such consent is secured.

* * * *

§1.471-6 *Inventories of livestock raisers and other farmers.*

(a) A farmer may make his return upon an inventory method instead of the cash receipts and disbursements method. It is optional with the taxpayer which of these methods of accounting is used but, having elected one method, the option so exercised will be binding upon the taxpayer for the year for which the option is exercised and for subsequent years unless another method is authorized by the Commissioner as provided in paragraph (e) of §1.446-1.

(b) In any change of accounting method from the cash receipts and disbursements method to an inventory method, adjustments shall be made as provided in section 481 (relating to adjustments required by change in method of accounting) and the regulations thereunder.

(c) Because of the difficulty of ascertaining actual cost of livestock and other farm products, farmers who render their returns upon an inventory method may value their inventories according to the "farm-price method", and farmers raising livestock may value their inventories of animals according to either the "farm-price method" or the "unit-livestock-price method".

(d) The "farm-price method" provides

for the valuation of inventories at market price less direct cost of disposition. If this method of valuing inventories is used, it must be applied to the entire inventory except as to livestock inventoried, at the taxpayer's election, under the "unit-livestock-price method". If the use of the "farm-price-method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, permission for such change shall first be secured from the Commissioner as provided in paragraph (e) of §1.446 -1.

(e) The "unit-livestock-price method" provides for the valuation of the different classes of animals in the inventory at a standard unit price for each animal within a class. A livestock raiser electing this method of valuing his animals must adopt a reasonable classification of the animals in his inventory with respect to the age and kind included so that the unit prices assigned to the several classes will reasonably account for the normal costs incurred in producing the animals within such classes. Thus, if a cattle raiser determines that it costs approximately $15 to produce a calf, and $7.50 each year to raise the calf to maturity, his classifications and unit prices would be as follows: Calves, $15; yearlings, $22.50; 2-year olds, $30; mature animals, $37.50. The classification selected by the livestock raiser, and the unit prices assigned to the several clas-

ses, are subject to approval by the district director upon examination of the taxpayer's return.

(f) A taxpayer who elects to use the "unit-livestock-price method" must apply it to all livestock raised, whether for sale or for draft, breeding, or dairy purposes. Once established the unit prices and classifications selected by the taxpayer must be consistently applied in all subsequent taxable years in the valuation of livestock inventories. No changes in the classification of animals or unit prices will be made without the approval of the Commissioner.

(g) A livestock raiser who uses the "unit-livestock-price method" must include in his inventory at cost any livestock purchased, except that animals purchased for draft, breeding, or dairy purposes can, at the election of the livestock raiser, be included in inventory or be treated as capital assets subject to depreciation after maturity. If the animals purchased are not mature at the time of purchase, the cost should be increased at the end of each taxable year in accordance with the established unit prices, except that no increase is to be made in the taxable year of purchase if the animal is acquired during the last six months of that year. If the records maintained permit identification of a purchased animal, the cost of such animal will be eliminated from the closing inventory in the event of its sale or loss. Otherwise, the first-in, first-out method of valuing inventories must be applied.

(h) If a taxpayer using the "farm-price

method" desires to adopt the "unit-livestock-price method" in valuing his inventories of livestock, permission for the change shall first be secured from the Commissioner as provided in paragraph (e) of §1.446-1. However, a taxpayer who has filed returns on the basis of inventories at cost, or cost or market, whichever is lower, may adopt the "unit-livestock-price method" for valuing his inventories of livestock without formal application for permission, but the classifications and unit prices selected are subject to approval by the district director upon examination of the taxpayer's return. A livestock raiser who has adopted a constant unit-price method of valuing livestock inventories and filed returns on that basis will be considered as having elected the "unit - livestock - price method".

(i) If returns have been made in which the taxable income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding taxable year. In this statement such adjustments shall be made as are necessary to bring the closing inventory for the preceding taxable year into agreement with the opening complete inventory for the current taxable year. If necessary clearly to reflect income, similar

adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such year or years.